

California Fair Political Practices Commission

MEMORANDUM

To: Chairman Randolph, Commissioners Blair, Downey, Huguenin, and Remy

From: Natalie Bocanegra, Commission Counsel
John W. Wallace, Assistant General Counsel
Luisa Menchaca, General Counsel

Re: Extensions of Credit (Section 85307 – Adoption of Proposed Regulation 18530.7)

Date: May 27, 2005

I. EXECUTIVE SUMMARY

This staff memorandum addresses the term “extensions of credit” as it pertains to the contribution limit rules. In the absence of contribution limits, the primary question raised with respect to extensions of credit dealt with how they were to be reported. However, with Proposition 34’s addition of section 85307 to the Political Reform Act (“Act”),¹ extensions of credit are reportable contributions subject to the Act’s contribution limits. (Chapter 5, Article 3.) Therefore, in the context of these limits, it becomes critical to determine if a particular payment is considered a contribution because it potentially subjects candidates and committees and persons who extend credit (i.e., makes a “payment”) to possible contribution limit violations.

At its April 2005 meeting, the Commission heard pre-notice discussion on this issue and considered two versions of a proposed regulation meant to explain when an extension of credit which consists of the provision of goods or services is subject to section 85307 and, in turn, the contribution limits. The Commission discussed an approach based on an “ordinary course of business” rule and an alternate approach based on the time period of the extension of credit. The Commission asked that staff develop a regulation incorporating elements of both rules for purposes of section 85307(a). The Commission also considered whether the proposed regulation should apply outside the context of the provision of goods or services and section 85307, but decided not to do so. At the Commission’s request, staff now presents proposed regulation 18530.7, which interprets section 85307 only.

The proposed regulation encompasses extensions of credit which consist of the provision of goods or services pursuant to an agreement between the provider of the goods or services and a candidate or committee where payment is not due until a later

¹ All references are to the Government Code unless otherwise noted.

date. The language provides that such a provision of goods or services is a contribution subject to section 85307(a). The proposed regulation also specifies exceptions to when an extension of credit is a contribution. The proposed regulation would not apply to local candidates and committees because section 85307 only applies to state candidates for purposes of applying the contribution limits of Article 3, Chapter 5 of the Act.

Staff supports the adoption of the proposed regulation as it addresses the contribution limit issues discussed above. The following recommendations pertain to the specific decision points:

- **Decision Point 1:** Optional language is proposed for subsection (b)(2)(A) which requires that the written instrument memorializing the credit arrangement be signed by the candidate or committee or an agent for the candidate or committee.
Recommendation: Staff does not offer a recommendation but addresses pros and cons of this optional language.
- **Decision Point 2:** Optional language is proposed which states that reasonable efforts to collect the full amount of the payment may be demonstrated even if the provider does not exhaust all available legal options or accepts less than the full amount owed.
Recommendation: Staff does not offer a recommendation on this language. While this language could offer some guidance, it may create confusion with regard to whether a provider could accept less than full payment as an alternate means of extending credit.
- **Decision Point 3:** Optional language is proposed which provides that the fulfillment of specified criteria will result in a complete defense for the provider of goods or services in any section 85307(a) enforcement action initiated by the Commission and show evidence of good faith conduct in any subsequent civil, criminal or administrative proceeding.
Recommendation: Due to the redrafting of proposed regulation 18530.7, staff believes this language is no longer necessary and does not recommend its inclusion.

II. BACKGROUND

Under the Act, a contribution is defined as:

“...a payment, a forgiveness of a loan, a payment of a loan by a third party, or an enforceable promise to make a payment except to the extent that full and adequate consideration is received, unless it is clear from the surrounding circumstances that it is not made for political purposes.” (Section 82015.)

A “payment,” in turn, means:

“...a payment, distribution, transfer, loan, advance, deposit, gift or other rendering of money, property, services or anything else of value, whether tangible or intangible.”
(Section 82044.)

Contributions are frequently thought of as cash payments, but contributions also include non-monetary contributions of goods or services. Regulation 18215(b)(3) defines the term “contribution” to include “[a]ny goods or services received by or behested by a candidate or committee at no charge or at a discount from the fair market value, unless the discount is given in the regular course of business to members of the public.” When a person donates goods or services to a committee free of charge, the person makes a non-monetary contribution to the committee. Similarly, when a person pays for services provided by another on a committee’s behalf, the payment is considered a non-monetary contribution to the committee which must be reported.²

A. “Extensions of Credit”

1. Pre-Proposition 34 Interpretation: Committees routinely engage in transactions that are commonly characterized as extensions of credit. Some examples from past advice letters³ are:

- Legal services provided to a candidate with the expectation that the services will be paid for at a later date. (*Bauer* Advice Letter, No. A-97-348.)
- Campaign services provided to a candidate with the expectation that the services will be paid for at a later date. (*Ammiano* Advice Letter, No. A-97-128.)
- Products provided to a committee pursuant to a consignment agreement. (*Miller* Advice Letter, No. I-97-143.)
- The cost of food, drink, and use of restaurant facilities provided by a restaurant owner until reimbursed by the candidate or committee. (*King* Advice Letter, No. A-97-127.)

Many of the examples involve the reporting of the provision of goods or services for which payment in full is not made by a candidate or committee at the time the goods or services are received.

The term “extensions of credit” is not currently defined in the Act or regulations although language of recordkeeping regulation 18401(a)(5)(B), adopted in 1992, contains the term. As used in this regulation, “extensions of credit” is one type of agreement reflecting the indebtedness which gives rise to a loan.

² Such a payment is referred to as a “third party payment.”

³ Many of these examples are taken from past advice letters interpreting provisions under Proposition 208, where a mandated 30-day period prompted requests for advice regarding extension of credit rules.

2. Proposition 34 Provisions: The current version of section 85307, added by Proposition 34 and amended by Senate Bill 1449 (Ch. 815, Stats. 2004), provides:

“(a) The provisions of this article regarding loans apply to *extensions of credit*, but do not apply to loans made to a candidate by a commercial lending institution in the lender’s regular course of business on terms available to members of the general public for which the candidate is personally liable.

“(b) Notwithstanding subdivision (a), a candidate for elective state office may not personally loan to his or her campaign, including the proceeds of a loan obtained by the candidate from a commercial lending institution, an amount, the outstanding balance of which exceeds one hundred thousand dollars (\$100,000). A candidate may not charge interest on any loan he or she made to his or her campaign.” (Emphasis added.)

Section 85307(a) has been read to provide a contribution limitation on “extensions of credit” consistent with the limit applicable to loans. (See Staff Memorandum to the Commission entitled, “Extensions of Credit (Section 85307 – Pre-notice Discussion of Proposed Regulation 18530.7),” dated April 6, 2005.)

Under the Commission’s current interpretation of section 85307(a), no person may extend credit to a state candidate in an amount prohibited by the contribution limits. With that in mind, the definition of “extensions of credit” becomes important since more people, particularly providers of goods or services, could potentially commit contribution limit violations. In addition, it seems likely that “extensions of credit” can only be contributions under the current provisions of the Act.

III. PROPOSED REGULATION 18530.7

In examining the past treatment of extensions of credit under the Act, staff believes it would be helpful to adopt a regulation that provides guidance as to when certain extensions of credit can trigger a contribution limit violation.

However, it should be emphasized that current reporting rules for accrued expenses are not altered by the proposed regulation; accrued expenses are required to be reported pursuant to section 82025. Essentially, by adopting a regulation regarding “extensions of credit” for purposes of section 85307, the Commission would address the question further as to when certain unpaid bills convert to a contribution. Therefore, the current reporting rules would still apply so that accrued expenses and contributions must be reported. As such, a candidate or committee would have to report on Schedule C a non-monetary contribution which resulted from an accrued expense previously reported on Schedule F, and the accrued expense would no longer be reported.

At its April 2005 meeting, the Commission heard pre-notice discussion on this issue and considered two versions of a proposed regulation meant to explain when an extension of credit was subject to section 85307. The Commission discussed an approach based on an “ordinary course of business” rule and an alternate approach based on a time period of the extension of credit.

Under the “ordinary course of business” rule previously presented to the Commission, an extension of credit was considered a contribution subject to section 85307 when it was:

- (1) A payment that involved the provision of goods or services pursuant to an agreement between the provider of the goods or services and a candidate or committee;
- (2) A payment that was not due until a later date; and
- (3) A transaction that was not within the “ordinary course of the provider’s business.” (See Attachment 1, Version A.)

This “ordinary course of business” approach was generally supported by members of the regulated community at the January 2005 interested persons’ meeting since its provisions allowed for the consideration of different types of businesses and business practices. For the same reason, the Enforcement Division raised the concern that the language could create obstacles to enforcement due to proof issues.

The language presented for the alternate rule based on a time period of the extension of credit was similar. However, under this approach, whether an extension of credit by a provider of goods or services was to become a contribution was based on whether a credit arrangement extended over a particular period of time. (See Attachment 1, Version B.)

The Commission asked that staff develop a regulation incorporating elements of both approaches for purposes of section 85307(a). As such, proposed regulation 18530.7 (Attachment 2) combines these elements. Specifically, the proposed regulation is meant to provide guidance as to when the provision of goods or services are contributions subject to the contribution limits solely for the purposes of section 85307(a). Staff believes this approach will provide guidance for implementation of section 85307(a) since any provision of goods or services would be governed.

As mentioned above, the proposed regulation would not apply to local candidates and committees because section 85307 only applies to state candidates for purposes of applying the contribution limits of Chapter 5, Article 3, of the Act.

A. Provisions

The proposed regulation encompasses extensions of credit which consist of the provision of goods or services pursuant to an agreement between the provider of the goods or services and a candidate or committee where payment is not due until a later

date. The language of **subdivision (a)** provides that such a provision of goods or services is a contribution subject to section 85307(a). The effect of this language is to impose the contribution limits of Chapter 5, Article 3 as previously discussed.

Subdivision (b) narrows the application of subdivision (a) by specifying when an extension of credit is *not* a contribution either made by the provider of the goods or services or accepted by the candidate or committee. Pursuant to the proposed language, there are two instances where an extension of credit will not be a contribution:

- Under **subdivision (b)(1)**, if the payment for the goods or services is made within a particular time period; or
- Under **subdivision (b)(2)**, if the circumstances surrounding the extension of credit meet certain criteria.

The time period during which the payment must be made in order to get the exclusion of **subdivision (b)(1)** is 45 days after the date of the invoice or from the date the goods or services are delivered.⁴ For services ongoing in nature, such as those provided over a specified period of time by a consultant pursuant to a contract, a provider, candidate, or committee need not assess the time period from each instance at which a service was provided. Instead, the date of the invoice may be used. However, to prevent extensions of credit from being extended over a protracted period of time, the services must be billed no less frequently than on a three-month billing cycle in order for this rule to apply.

Subdivision (b)(2) provides a second way in which an extension of credit will *not* be considered a contribution. This subdivision provides criteria to distinguish those situations where a vendor is carrying on business as usual with no intention of making a political contribution and will not apply if a particular transaction is not in the ordinary course of business. The approach incorporated into subdivision (b)(2) was supported by a number of people attending the January 13, 2005, interested persons' meeting on this topic who believed it is desirable to allow a case-by-case determination as to whether an extension of credit is a contribution.

These criteria require that:

- The credit arrangement for the provision of goods or services is recorded in a written instrument (subsection (b)(2)(A));
- It is a primary business of the provider of goods or services to provide similar goods or services (subsection (b)(2)(B));

⁴ This method of determining the relevant time period is different from the method presented to the Commission at the April 2005 meeting. Staff believes this method is easier to apply.

- The provider provides the goods or services in the ordinary course of business and on the same terms and conditions offered to customers generally (subsection (b)(2)(C));
- The provider of goods or services enters into the agreement with the intent that the candidate or committee be required to pay in accordance with the terms of the agreement, and does not have actual knowledge of the candidate or committee's inability to pay in accordance with those terms (subsection (b)(2)(D)); and
- The provider of goods or services makes reasonable efforts to collect the full amount of the payment owed within four months of the date that the payment for the goods or services is due under the terms of the agreement (subsection (b)(2)(E)).

Optional language **{Decision Point 1}** is proposed for subsection (b)(2)(A) by the Enforcement Division and requires that the written instrument memorializing the credit arrangement be signed by the candidate or an agent for the candidate or committee.

In addition, optional language **{Decision Point 2}** is proposed which states that reasonable efforts to collect the full amount of the payment may be demonstrated even if the provider does not exhaust all available legal options or accepts less than the full amount owed.

Subdivision (c) is presented as optional language **{Decision Point 3}**. Under this optional subdivision, if the criteria of either subsection (b)(1) or (b)(2) are met, then it shall:

- Be a complete defense for the provider of goods or services in any enforcement action based on section 85307(a) which is initiated by the Commission; and
- Be evidence of good faith conduct in any subsequent civil, criminal or administrative proceeding.

B. Staff Recommendations

Staff supports the adoption of the proposed regulation as it addresses the contribution limit issues discussed above. The following recommendations pertain to the specific decision points:

Decision Point 1: Optional language is proposed for subsection (b)(2)(A) and requires that the written instrument memorializing the credit arrangement be signed by the candidate or an agent for the candidate or committee.

Recommendation: Full consensus was not reached by staff on this decision point. Therefore, staff does not offer a recommendation on this language but points out that this criterion could, at times, be inconsistent with the regular

practices of a particular business. On the other hand, the requirement that the written instrument be signed, as proposed by the Enforcement Division, offers the benefit of clearly showing that the candidate or committee entered into a contract for goods or services.

Decision Point 2: Optional language is proposed which states that reasonable efforts to collect the full amount of the payment may be demonstrated even if the provider does not exhaust all available legal options or accepts less than the full amount owed. Under this language, it could still be shown that a provider did *not* make reasonable efforts to collect the full amount if the provider did not exhaust all available legal options or accepted less than the full amount of payment, provided that other facts indicating a failure to make reasonable efforts were also present.

Recommendation: Staff does not offer a recommendation on this language. This language may be beneficial because it offers guidance regarding the circumstances under which it could still be demonstrated that reasonable efforts to collect the full amount were made. On the other hand, the Enforcement Division believes that this language could create problems since, under this language, it may appear that a provider could accept less than full payment as an alternate means of extending credit. Furthermore, proof could be difficult to establish where the provider may have initially asked for full payment. Therefore, the Enforcement Division would oppose inclusion of this language.

Decision Point 3: Optional language is proposed for subdivision (c). Under this language, if the criteria of either subdivision (b)(1) or (b)(2) is met then it shall be a complete defense for the provider of goods or services in any section 85307(a) enforcement action initiated by the Commission, and be evidence of good faith conduct in any subsequent civil, criminal or administrative proceeding.

Recommendation: This optional language is based on language initially developed as a safe harbor for vendors under Proposition 208, which provided that extensions of credit for “a period of more than 30 days” were subject to the contribution limits. This safe harbor was developed to address the inflexibility of the 30-day time period. Given the structure and provisions of proposed regulation 18530.7, staff believes the optional safe harbor language is redundant and, therefore, not necessary. Specifically, the proposed regulation is structured to exclude certain extensions of credit from being contributions. Moreover, these exclusions can be based on either the time period over which the credit is extended or on considerations related to the regular practices of a particular vendor. If included, this language could potentially create confusion as to how subdivision (b) should be applied.

Attachments

Attachment 1 – Versions A & B of Draft Language Presented at April 2005 Meeting

Attachment 2 – Proposed Regulation 18530.7